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U.S.-U.S.S.R. Summit Leaves Japan-Soviet Picture Unclear

The outcome of the U.S.-U.S.S.R. summit in Iceland October 11-12 has added a new twist to the anticipated meeting in Tokyo between Prime Minister Yasuhiro Nakasone and Soviet leader Mikhail Gorbachev. The abrupt conclusion of the Reagan-Gorbachev meeting without agreement on cutbacks in strategic nuclear forces makes the timing of Mr. Gorbachev's trip to Japan a delicate matter. While there are both advantages and drawbacks to an early meeting, the collapse of the Iceland talks might reduce the incentives in the short term and favor delay ~~until well~~ into 1987.

While Japanese officials had pressed for a Nakasone-Gorbachev meeting before the end of the year when they discussed the matter at the United Nations in September, Soviet officials declared that more pressing matters with the United States demanded attention and that at best a session could not be

perceived as undercutting the possibilities of a U.S.-U.S.S.R. agreement on intermediate-range nuclear forces by insisting on a particular level of reductions in Soviet Asia.

Peking's reaction to the Soviet offer is also important since the SS-20s presumably would have remained targeted primarily at China, leaving in question the implicit U.S. commitment to that nation. Even in this case, however, resentment might have been limited since SS-20 reductions would have been traded for delayed SDI deployment, a plus in the minds of Chinese analysts.

The upshot is that the developments in Iceland have increased the sensitivity of the anticipated Nakasone-Gorbachev meeting. Representatives of both the American and Soviet governments are en route to Tokyo to brief officials there, indicating the importance of Japan and its respective bilateral relationships with the two countries. Nevertheless, the present state of U.S.-Soviet relations makes the timing of the Japan-Soviet session especially delicate.

Michael W. Chinworth

The Effect Of The Yen's Appreciation On Japanese Export Prices

The decline in the dollar during the past 18 months has failed to stem the expanding U.S. trade deficit. One obvious reason is that the depreciation of a currency first worsens a country's trade balance before it alters the volume of trade (the J-curve effect). But a second factor is that the prices of many imported goods do not fully reflect the currency changes that have taken place. At least over the short run, many foreign producers prefer to cut costs and sacrifice profits rather than lose market share by raising prices the full amount of the currency changes. Japanese cost-cutting efforts have been aided by less expensive industrial inputs, particularly oil.

Japanese exporters have passed on only half of the yen's 47.1 percent rise against the dollar in the form of price increases in the 10 months from September 1985 (see Table). This is substantially less than the two-thirds hike in the February-November 1978 period, when the yen appreciated 30.6 percent. One reason for this is that with relatively low inflation in 1985-86, price increases are more likely to reduce market share. Inflation in the United States is in the 3 percent zone this year, for example, compared to 7.7 percent in 1978. Moreover, three years of record or near-record profits have allowed Japanese industry to hold the line on price increases.

Of the 14 industries for which data are available in both periods, 11 passed on a smaller percentage of the yen appreciation in 1985-86 than in 1978. One explanation is that many of these industries face increased competition, particularly from the newly industrialized countries of Asia. Automotive manufacturers in 1978, for example, passed on almost 90 percent of the yen's appreciation. As of July 1986, in contrast, that figure was only 57.6 percent. And much of the increase apparently occurred outside the U.S. market; the prices of Japanese cars have reportedly risen only about 15 percent in this country (a 32 percent pass-on ratio). Steel and ships, which had the lowest price increases, face stiff competition, particularly from Korea, as well as stagnant demand.

Percent of Yen's Appreciation Passed on in Export Prices*

Industry	February-November 1978	September 1985-July 1986
Clothing	79.6%	40.4%
Organic Chemicals	25.5	28.8
Inorganic Chemicals	n.a.	10.5
Steel	80.2	4.7
Nonferrous Metals	71.2	15.0
Metal Products	83.1	43.4
Nonelectric Machinery	59.2	71.4
Data Processing Equipment	n.a.	58.7
Electric Machinery	74.5	56.5
Color Television Sets	57.3	48.9
Radio Receivers	69.3	51.4
Other Telecommunications Equipment	n.a.	51.1
Semiconductors and Electronic Tubes	n.a.	18.4
Integrated Circuits	n.a.	27.6
Motor Vehicles	89.3	57.6
Motorcycles	83.8	55.4
Ships	21.5	10.2
Precision Instruments	82.8	47.8
Cameras	67.0	70.6
Copiers	n.a.	78.4
Video Cassette Recorders	n.a.	15.3
Total Exports	66.3	49.3

*The yen appreciated 30.6 percent against the dollar during the February-November 1978 period and 47.1 percent between September 1985 and July 1986 based on the conversion rates used for customs clearance.

Source: Calculated from The Summary Report: Trade of Japan

The considerable variation by industry is due to factors other than the extent of foreign competition. The amount of yen appreciation passed on by exporters of basic industrial intermediates, such as steel and nonferrous metals, was especially low. In some finished products, the reputation of well-known Japanese brand names has permitted larger price increases. Producers of cars, cameras and copiers have been able to pass on a relatively high percentage of the yen's appreciation.

The failure of many exporters in Japan and elsewhere to raise prices by the full amount of the currency changes has left them open to dumping charges. Timken Co., one of the world's largest producers of roller bearings, used this argument in filing dumping charges against Japanese manufacturers. If the Commerce Department concludes that Japanese makers are selling products here at less than fair value because they have not made appropriate adjustments in export prices, more complaints like Timken's can be expected.

Randall S. Jones